Rev. Rul. 65-219, 1965-2 C.B. 168, distinguished, Rev. Rul. 67-302

A club which is operated under an agreement with its resident agent whereby he controls the size of the club membership, the amounts of initiation fees and annual club dues, and retains all initiation fees and 90 percent of dues and transfer fees in return for the exclusive use of the swimming pool which he owns and operates is not exempt from Federal income tax under section 501(c)(7) of the Internal Revenue Code of 1954.

Advice has been requested whether an organization formed for the purpose of operating a swimming club may be exempt from Federal income tax under the circumstances set forth below.

The instant organization was incorporated as a nonprofit corporation for the purpose of establishing and maintaining a swimming club, for the social, athletic, and recreational benefit of the members. Soon after incorporation, the club entered into a license agreement with its resident agent, whereby the resident agent agreed to pay for the construction of an olympic-size pool for exclusive club use, on a tract of land which he had leased. The agreement permits the club to use the property as a licensee for a period of 20 years, with an option to renew for an additional 20 years. In addition to undertaking the expense of constructing the pool, the licensor agreed to pay for the support and maintenance of the pool, and to furnish personnel necessary for its efficient operation.

The club agreed to pay the licensor all monies collected as initiation fees from members, 90 percent of all annual dues, and 90 percent of all transfer fees. Under the terms of the agreement the licensor controls the size of the club membership, the amount of initiation fees, and the amounts of annual club dues and transfer fees. The licensor reserved the right to operate a snack bar or other concessions on the pool premises. Under the agreement the club receives no equity in the pool or other property although financed by members' initiation fees. The club cannot assign the agreement without written consent of the licensor. It was agreed by the parties that the licensor would be responsible for managing the club and securing memberships.

Section 501(c) of the Internal Revenue Code of 1954 describes certain organizations exempt from Federal income tax under section 501(a) of the Code and provides, in part, as follows:

> (7) Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder.

Section 1.501(c)(7)-1 of the Income Tax Regulations provides, in part, that the exemption provided by section 501(a)

of the Code for organizations described in section 501(c)(7) of the Code applies only to clubs which are organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, but does not apply to any club if any part of its net earning inures to the benefit of any private shareholder.

The arrangement in the instant case goes beyond the normal management contract whereby a club is saved the burden of administrative details by paying a reasonable rental to an outside operator in the form of a share of the receipts. The licensor has the power to control the amount of income by virtue of his control with respect to solicitation, number, and transfer of memberships as well as his control over the amounts of initiation fees, transfer fees, and annual club dues. He does, in fact, under the agreement, receive 100 percent of all initiation fees and 90 percent of all membership dues and transfer fees.

Accordingly, it is held that the club is operated as a commercial venture for the financial benefit of the licensor and is not exempt under section 501(c)(7) of the Code.